RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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December 10, 1976 **LETTER 683**

Nov.26, DJIA 956.62; PTI 741; A-D Ratio -21.82
Dec. 3, DJIA 950.55; PTI 751; A-D Ratio -21.57

THE PICTURE: From what I hear, President Ford is genuinely angry that he lost the election. The general picture one gets of him is that he's sulking and slinking around in various dark corners of the White House, perhaps sticking pins in photos of Jimmy Carter. Carter is trying to play it cool, and he's doing the best he can with a difficult situation (could anything be more difficult than the bunch of public relations idiots in the steel industry who announced the phony steel price rise prior to the OPEC oil resolution and just prior to the new President's inauguration?).

Everybody's been uptight about those thirty D-J Industrial stocks The "smart boys" have been worried about the currencies crises and the competitive devaluations and their effect on multinational earnings. And then there's the new replacement accounting to fret about (that starts in January). And we know that overseas competition is getting fierce, because Europe is in a slump and the Europeans are going to be dumping everything from steel to stockings on the US markets. The overseas recession is hurting the US corporations who own those once-profitable foreign operations. Now if you're a multi-national, you're in the same class as someone who has all his money in uptown Manhattan real estate. So much for the troubles of the Dow.

Of course, my own feeling is that all the above is news. All news is history, as far as Wall Street is concerned, and therefore ***fully discounted*** in the price structure. What you know and I know the market knows, and what the market knows is no longer a factor in the price trend.

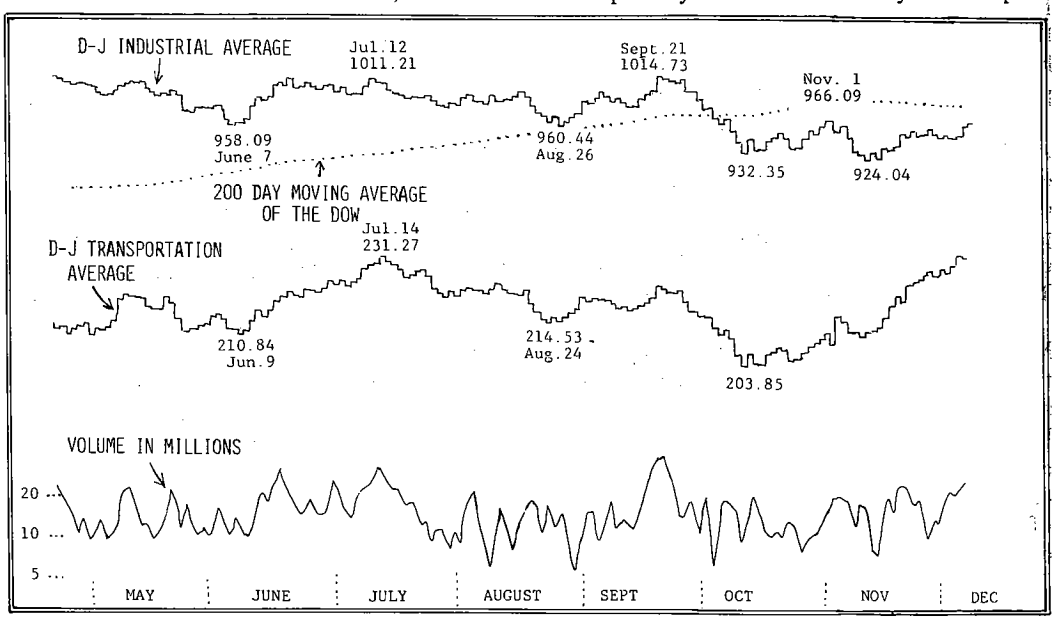
I'd say the same as far as the glamour stocks are concerned. I think the selling here has been overdone, and that some of the leading chemicals and electronics and former "growth stocks" are in the buying range at this point. It's true that the institutional boys have cooled off on the growth concept ("that was alright for the 1960's when the nation was really growing"). Actually, the institutions and the money managers have been piling into the big bull market in bonds and utilities, and it's been up, up and away in that favored area. After all, the experts reason, if the money vehicles pay you a sure 6% to 9%, isn't that better than you could have done in common stocks over the last decade? Besides, inflation isn't a sure thing any more, but bond and utility yields are.

All of which is true, and I've been talking bonds and yields so much over the past year that I don't even like to hear my own voice on that subject any more. But my job is to deal with the problem of "What do we do now," not "Here's what happened yesterday." And my own opinion is that the bargain zone is slowly but steadily moving ***towards common stocks*** (although I want to emphasize that I still like bonds). For instance, Will-Go (a statistic based on the relationship between bond *yields* and stock *yields*) has been rising for 21 consecutive weeks, with the ratio moving steadily in favor of common stocks. This, by the way, is the *longest* consecutive rise in Will-Go that I have ever seen, and it is implying that the yield factor is exerting a powerful pressure in favor of higher prices for common stocks.

So my general overview is this: We have a primary bull market in bonds, a primary bull market in stocks, and both in the face of a rather listless business picture. This sloppy business condition has encouraged many analysts to turn bearish on the whole situation, a position that I believe they will live to regret. For the fact is that the stock market of late has proved to be all but ***immune to bad news***, and that's bullish. It means, simply enough, that all the bad news has been discounted.

As usual, I find that the scarcest commodities around are (1) a belief in the prevailing major or primary trend, which is (and has been all along) bullish, and (2) patience.

At this point I want to make another observation. It is currently fashionable in the advisory business to talk about "one more leg, the third and final advancing leg for this bull market," and "the end of the bull market in early or mid-1977." Now I'm not an oracle or a crystal ball practitioner, but I do know that primary bull markets seldom unfold according to the scenerios put forth by market advisors. Therefore, I'm skeptical of the "it's all over in 1977" concept. Maybe it will be over, and maybe not, but I do know that primary bull markets usually don't expire



"on schedule." Rather they tend to go considerably further and longer (in duration) than expected.

This second phase of the bull market has been interrupted (held back) ever since February, 1976. It's had ten months of consolidation, ten months of rising bearishness, ten months in which informed investors could accumulate. Therefore, I wouldn't be surprised if the second phase of this bull market takes stocks higher than the skeptics are planning on----over a longer span of time.

TECHNICAL PICTURE: At present, I would term the market picture both interesting and encouraging. Next, I want to discuss the situation from the standpoint of the price structure and from the standpoint of Dow's Theory, so please turn to the page 1 chart of the Averages. Note that the last confirmed lows for the Averages were recorded in mid-October, Industrials at 932.35 and Transports at 203.85. At that time I wrote that in my opinion, the mid-October lows "represented the worst that could be seen ahead, from OPEC to NYC, from Carter to the soft business picture."

Following the mid-October lows, the Averages rallied strongly. But the Industrials halted their climb at the November 1 peak of 966.09. A new decline then took Industrials on a solo drop below their mid-October low---to a new 10-month low of 924.04 (recorded November 10). The transports ***refused by a wide margin to confirm.***

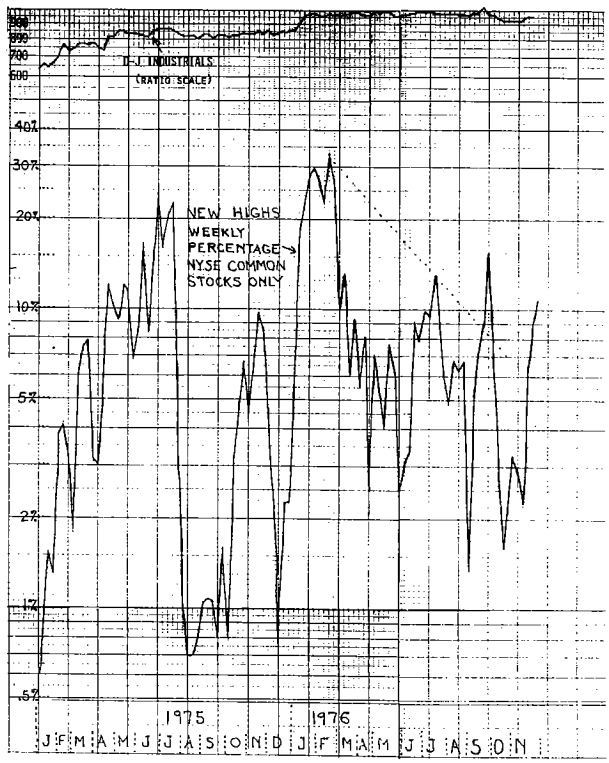
I wrote that the November 10 non-confirmation on the part of Transports was more significant and most important. It came amid great public pessimism, and in the face of the first thoroughly sold-out market since late-1975. I felt that the situation looked bullish, and in this area I recommended additional purchases of common stocks (as per Letters 681 and 682).

All of which takes us to the current market. From the standpoint of the Averages (as I write this Letter), we have a Transport Average that has been hitting new highs almost daily. We have a powerful bull market in bonds that has been taking the widely-watched D-J 20 Bond Average to successive new highs. And we have a D-J Industrial Average which has been lagging over the past few months, but which may be ready to join the upward parade. As noted in the last report, the initial upside target for the Dow is the November 1 peak of 966.09. If the Dow betters that level, I believe that the odds favor new bull market highs within a matter of weeks, and of course the September 21 peak of 1014.79 represents the high for this primary bull market.

As this is written, the market faces a technical problem that often emerges when one Average has been lagging and a strong rally occurs. The Transports are now within a hair of their July 14 peak of 231.17. It is obvious that if this rally continues, we are going to have a new Transport high unconfirmed by Industrials. The question---will this be a danger signal?

My answer is perhaps, but again I'll repeat that we have to give the ***primary trend every benefit of the doubt***. Just as I was skeptical of the danger when Industrials broke to a new low below their October lows unconfirmed by Transports, I am also skeptical of the danger of a new high by Transports not yet confirmed by Industrials. In the majority of cases, a penetration of one Average IN THE PRIMARY DIRECTION is ultimately confirmed by the laggard Average. Therefore, although a new Transport high (without Industrial confirmation) could bring in a little or even a good deal of reactionary or backing and filling action, I do not think it will mark an area of extreme danger. And I think that in time Industrials will move to new highs.

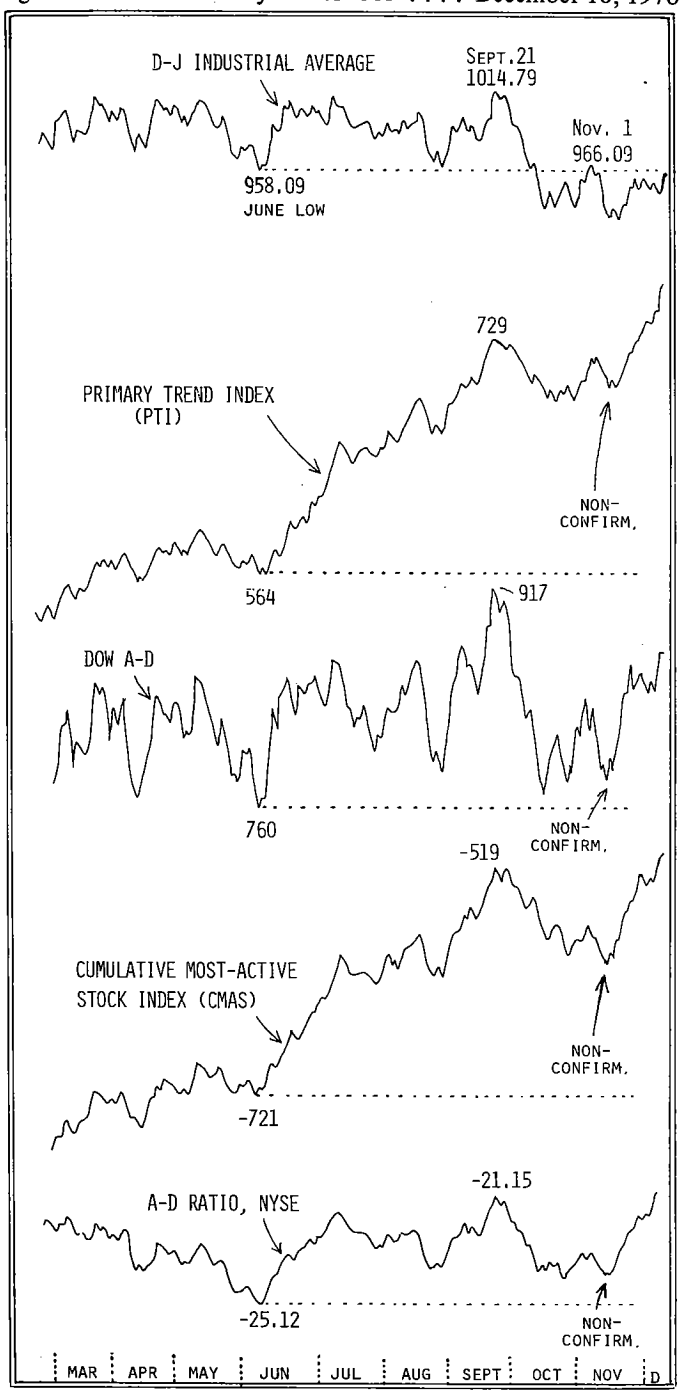
The technical background on Wall Street remains bullish. The high-lows (weekly statistics) are very encouraging in that at no time this year has the weekly differential figure dropped as low as minus 100, but last week the differential figure jumped to plus 234. My special statistics on NYSE common stocks alone (omitting preferreds) rose to 10.6%, meaning that for the week ending December 3, 10.6% of all NYSE common stocks rose to new highs for the past 52 weeks. This new high percentage has been rising for the past seven weeks, and I illustrate this on the accompanying chart.



The ***odd lot*** statistics are encouraging at this time. The public is still selling heavily into this market, but since early November their selling has *increased* considerably---to the point where the odd lot public is now selling about 225 shares for every 100 purchased. The inference here is that big money is taking the market higher---and that's good.

In Letter 680 (page 3) I included a study of the ***"groups advancing,"*** and I stated that by the first quarter all groups should be moving higher. Last week the groups advancing pushed above the 50% level (to 54%), and that's a bullish signal on this study. My guess is that the first or second quarter of 1977 should see a peak in groups advancing (at which point the market could get selective, although a top would *not* necessarily be indicated).

Next I want to turn to the chart (page 3) of the Dow and the four breadth indicators which have served us so well all year. The *Primary Trend Index* (made up of eight important components) has led the way, hitting successive new highs over the past two weeks. The *Dow A-D Index*, which is an advance decline line of the 30 Dow Industrials, provided a striking non-confirmation at the October and November lows. This meant that the decline in the Dow was concentrated in a ***few*** Dow stocks. But the Dow



A-D has been strong on the rally, indicating broader Dow participation on the upside--which is bullish.

The *cumulative most-active stock index* (CMAS) gave a very bullish indication by spurting to a new high on December 6. This indicator often leads the rest of the market, since it is actually an index of the advancing or declining tendencies of the most active stocks on the NYSE. Since big money is what generally puts a stock on the most active list, CMAS is a fairly reliable barometer of what big money is doing.

Finally, we have the *advance-decline ratio* which tells us what all NYSE stocks are doing. On December 6, the day of the new high in the CMAS, the A-D Ratio exactly matched its previous peak recorded on September 22. I have seldom seen CMAS and the A-D Ratio move to highs simultaneously. I would have to think that such action indicated very broad upside participation.

Conclusion: The "market" is still considerably stronger than the Dow. This can cause churning and even reactionary tendencies, but the underlying situation remains, to my mind, bullish. Those subscribers who have my historical A-D Ratio chart album might examine the period around 1942-43, at which time breadth acted consistently better than the Dow. Now, as then, I would expect the Dow to catch up to the A-D, but I am in no hurry, and the market couldn't care less. Wall Street does everything on its own time. The market has never gone out of its way to make things easy for stockholders or market advisories. The operative thought, however, is that this is (and remains) a primary bull market.

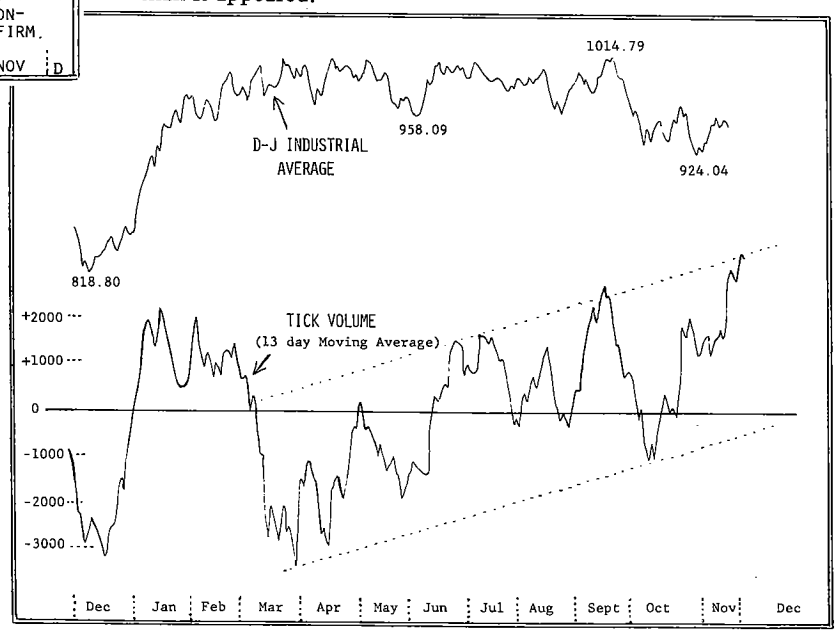
TICKS:In Letter 670 (July 21) I discussed "tick volume." This is a tablulation which can be obtained from the "punch out" machines now seen in most brokerage houses. What the tick volume shows is a reading on all the *last* up-ticks and the *last* down-ticks on the NYSE at any given time. For instance, if a stock has dropped two points from the previous day's close, but it has up-ticked on its *last* trade, that stock will show as an up-tick on the tick volume.

What I do is take ***closing*** tick volume (both up and down) and compute the differential. This gives me a reading on the trend of "upward pressure" or "downward pressure" ***at the close***. Thus, theoretically, the advance-decline reading for the day could be down, but late strength could give a plus reading on the tick differential.

I am including here a section of my chart of the closing tick differential tabulated in the form of a 13-day moving average. The tick volume, as shown here, tends to show the upside or downside pressure on the mass of stocks and it usually precedes movements in the advance-decline ratio.

It is well worth following the action of the tick volume over the past year as shown on the chart. From December, 1975 through January 1976, tick volume (13-day moving average) exploded to a peak of plus 2305 (January 20). Following that surge, tick volume collapsed to a March 30 low of minus 3404. During that period the A-D ratio roared up in a "buying panic," hitting a 1976 peak on February 24. But as if ***following the tick volume lead,*** the A-D ratio topped in February (one month after the tick top) and declined to a June low.

In the meantime, note that the ticks were climbing steadily higher and in early September the ticks hit a high of plus 2800. This occurred at a time when the A-D Ratio was refusing to follow the Dow to new highs and when many people were expecting a breadth collapse. The powerful tick readings were telling us, however, that the market's undertone was far stronger than it appeared.



Now comes the very recent and current story. From the September high, the ticks dropped to minus 1000 in early October. By mid-October, with the A-D ratio under its August low and with the Dow at its lowest level since January, the ticks had climbed to better than plus 1000. Following that the tick volume pushed up again, and by early December the 13-day moving average stood at plus 3515.

The rising parallel lines have contained all tick action until the explosive upside burst of the past week. What impresed me with the ticks ever since June of this year is that regardless of what the market or the A-D ratio was doing, the ticks almost always closed at a plus figure at the end of the day. In fact, except for the brief spate in October, the 13-day MA of the ticks held with few exceptions above the zero line. This, to my mind, meant accumulation, buyers coming in following all periods of intra-day weakness.

Early this week the tick volume index suddently exploded to plus 3515, the highest reading for which I have any record. This could mean a temporarily overbought market and perhaps some backing and filling around this area. But I also think the upward spurt of the tick index above the channel represents a kind of massive impulse or upward thrust. I feel it is telling us that much higher stock prices lie somewhere ahead.

DIVIDENDS: There's an outfit here in La Jolla that does a really definitive job of tracing dividends and stock values. It's *Investment Quality Trends* (7440 Girard Ave., Suite 4, La Jolla, CA 92037). IQ Trends bases its market approach on ***dividends*** paid by quality stocks. They note (as did Charles Dow) that there is a very ***basic difference*** between what a stock pays out in dividends and the much more widely-followed statistic of what a stock earns.

It has been said that earnings are what an accountant says a stock earns. And to a large extent that is true. But let's listen to this piece from the latest IQ Trends. "*There is no more accurate indication of fiscal achievement in a publicly held corporation than a trend of rising dividends. Dividends are the REAL money, cash in hand, a visible and spendable return on one's investment. There is no mystery, there can be no subterfuge about a cash dividend. No amount of hanky-panky in the bookkeeping department can produce dividend dollars where none exist.* ***Dividends can only rise from the reality of earnings.*** *A rising trend of dividends is tangible evidence to stockholders that there is, indeed, a rising trend of earnings. Steadily increasing dividends offer proof positive that a corporation is making profitable progress.*"

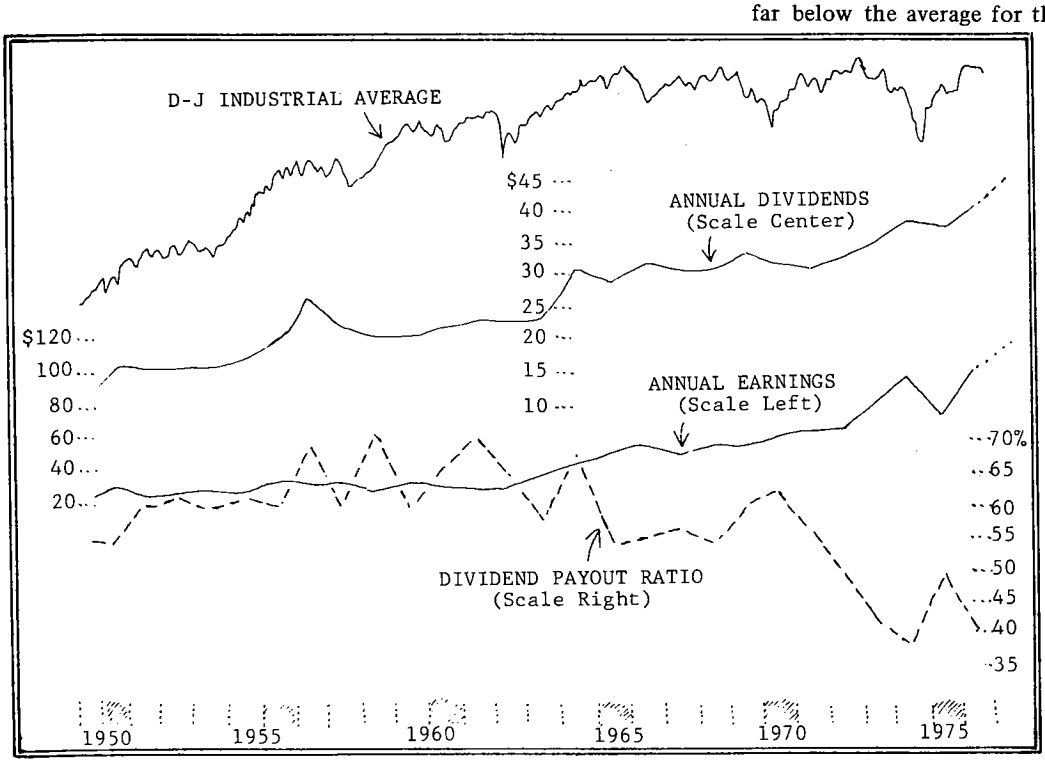
I could not agree more. For instance, even in the depths of the Great Depression, in 1932, when the total cumulative Dow Industrials earnings collapsed to a net deficit, the Dow still paid $4.62 in dividends. Thus the dividend approach was saying that these companies (on average) still had dividend-paying power, they were still values.

I find the dividend approach particularly interesting at this time, since I feel it is at great variance with the prevailing depressed and skeptical psychology. For instance, IQ Trends carefully monitors 350 quality dividend paying stocks. They note that of those 350 companies, a whopping 273 have increased their dividends in 1976 (some have increase the dividends more than once). That's 78% of the total.

What this is telling me is that despite the gloom, despite the ominous predictions, ***an awful lot of companies are doing well,*** and they are generating cash and paying out increased dividends. A company does not raise its dividend lightly. Remember, dividends are paid out after taxes (unlike bond interest), and thus dividends represent hard-earned after-tax cash. To raise its dividend a company must hold a reasonably bright view of the future based on its books, its corporate savvy and what its salesmen are saying and doing.

I have drawn up a chart of the Dow Industrials covering the years 1949 to 1976. What we see here is annual earnings for the Dow, annual dividends and the dividend ratio (what percentage of earnings is paid out in the form of dividends). These figures are all based on statistics provided by *Value Line*.

It seems to me that the chart is telling a rather fascinating story. First we see that Dow earnings are estimated to be $102.10 for 1976 with a total dividend payout of $40.74. If this is true, then the Dow is selling at only 9.3 times this year's earnings. Just as interesting is the fact that the dividend ratio is now down at 40%, far below the average for the past 25 years. In other words, the percentage of earnings being paid out by the Dow stocks is very conservative today.



Value Line estimates earnings for the Dow at $119 for 1977 with dividends at $45.86. I spoke to their editor last week and asked him about replacement accounting. He said that this could knock about 25% off Dow reported earnings (this year and next). He also stated that the quality of Dow earnings would improve with replacement accounting (which, of course, I agree with). Thus, if the Dow earns $90 next year based on replacement accounting, it would be selling for 11.1 times earnings at 1000, not an unreasonable figure.

My own feeling is that the current conservative Dow P/E figure and the current very conservative dividend payout (40%) has discounted the effects of the replacement accounting (which will be visible next year). In all, I believe that

we are currently seeing a conservatively priced market which will be subject to realistic accounting principles (honest earnings) during 1977.

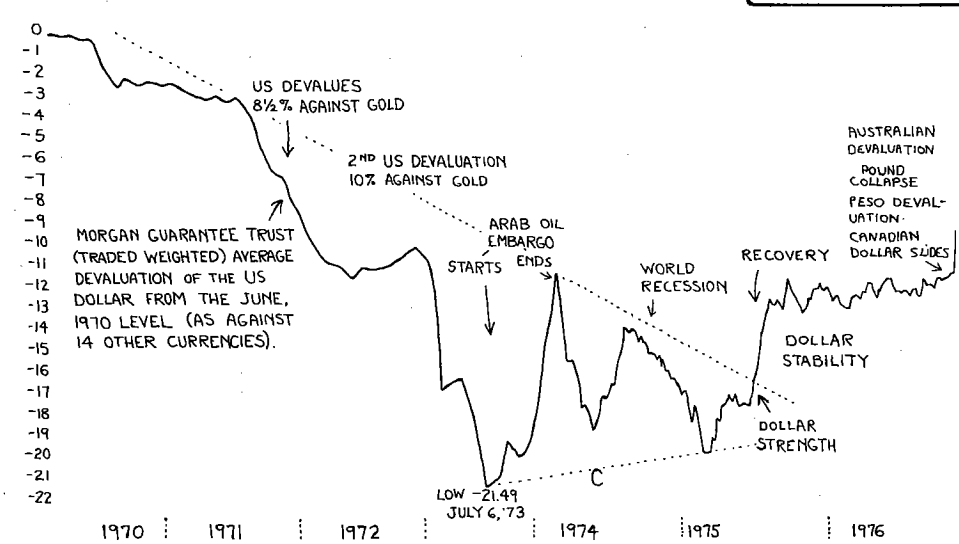
Another whole area of possible bullish potential would be an ending of "double taxation" on corporate dividends. I believe this is an idea whose time has come. Mr. Ford did not have the boldness to bring it about. I think Carter just might do it. I can't think of anything that would be more bullish for Wall Street than an end to the double taxation of dividends.

DOLLAR STRENGTH, US SUPREMACY: In Letter 680 I wrote a piece in which I stated that the focus of world economic power was moving back ***towards the US***, following a decade in which it seemed as if Europe would assume leadership of the Free World. The trend of events is now moving even more rapidly towards the scenerio which I predicted.

As a nation's currency goes, so goes its power. And the undeniable fact is that the dollar is becoming the most wanted currency in the world today. In mid-1975 I presented a chart (updated here) in which I showed that the long declining trend of dollar weakness had reversed to the upside. The dollar, I wrote, is now entering a bull market against other currencies. Since then we have seen a long period of either dollar stability or dollar strength. The chart says it all.

Actually, I didn't need my charts to tell me that the dollar was an under-valued currency. I used to run down to Mexico every other weekend (Mexico is only 20 miles south of San Diego), but I ended my weekend journeys about three years ago. I ended them because I felt that Mexico was becoming a rip-off. There weren't any values left in Mexico, at least not near the border. A few months ago we went north to Vancouver. My comment about Vancouver, "beautiful but over-priced compared to what you can get in the US." Friends back from Europe have told me the same thing. " Stay away, Europe is way over-priced. Your dollar buys a whale of a lot more here in the US."

Over the past few months the Mexican peso has utterly collapsed. Two weeks ago the Canadian dollar caved in against the US dollar, first dropping under par, then sinking to 96½ cents. During the same week Australia devalued by 17½ %. New Zealand in turn devalued. Meanwhile the Morgan trade weighted dollar index jumped (see chart) to its highest level since 1972, and the trend is still to higher levels.



Britain's pound is now in shambles against the US dollar (and against most other currencies). The absurd and bumbling British welfare state has reduced the once-powerful British economy to the status of a rusty antique, and the English standard of living is heading into the basement. But what of the Swiss franc and the German mark, the European bastians of value and purchasing power? My answer: they're both too high, way out of line with the dollar. I believe that they've both topped out against the dollar and will be heading lower. My guess, perhaps 15% to 20% lower.

The word from overseas bankers in this, "Invest in the US stock market, invest in US real estate, forget the other markets." The fact is that US productivity coupled with good values, sliding US inflation, excellent values and a stable US government (run under a Constitution) makes the US the world's best and most attractive place to put money.

If Mr. Carter will follow his "country boy business instincts," the instincts and abilities that made him personally worth around $5 million, and apply those same instincts to running the country, then I believe we will be going into the period that I predicted in Letter 680. That period will represent a rise in US economic power greater than anything seen since World War II. I think it's going to happen. I think that the bond markets and the stock markets may be looking ahead to just such a picture as 1977 looms into view.

FURTHER COMMENTS: Last week a leading advisory service stated that with US interest rates coming down, money will shortly pour out of the US toward higher-yielding foreign shores. This will bring down the dollar and cause a US bank panic. To which I say, "Forget it. Big money opts for ***safety first***, yield second, and possible appreciation third." The safety is right here in the US. This is where the safety is, and this is where the money is landing. And I don't care whether England pays 25% or Italy pays 35%, the big money will continue to come here as long as the US is the island of safety. All of which, of course, will keep downside pressure on interest rates.

Next, I note that our California savings & loan associations are paying 6½% for one year money and 7-3/4% for six year money. The S&Ls, like the banks, are in dreamland. They are still reading the newspapers and waiting for money to "tighten up again." They're thinking in terms of recent history, and they

From our "I TOLD YOU SO" department:

THE WALL STREET JOURNAL, Wednesday, Dec. 1, 1976

U.S. Dollar Hits Strongest Level In Nearly 4 Years

It Gains Against Canadian Currency, Japanese Yen, But Eases Against Pound

A WALL STREET JOURNAL *News Roundup*

World-wide monetary turbulence has propelled the U.S. dollar to its strongest position in almost four years.

In active dealings yesterday, the U.S. currency gained yet more ground against its ailing Canadian counterpart in Montreal, and it posted a sharp gain against the Japanese yen in Tokyo.

do not understand that this is a bull market in bonds (with declining yields). Once the money institutions get this through their heads, they'll cut their payment rates—with a vengeance. At that point, a good deal of frustrated savings money is going to pour into the bond market to lock up what's left of higher interest rates.

Now let's turn to certificates of deposit (C/D's). These certificates, sold by the banks, have been paying around 5½% on 90-day money. But I expect the banks won't even be wanting to sell them before long. The C/D money, which is now running off (i.e., not going back into C/D's), is going to be hitting the bill and note market, driving those yields down (90-day T bills are now yielding around 4.4%). Next step is T-bill money moving into longer term paper and open-end bond funds.

STOCKS: I don't have room enough, but if I did I would show my relative strength charts of major groups. What is evident to me is the outstanding and *continuing* strength in the money oriented groups and stocks. Still looking very strong is the *Utility Group* and the *Financial Group* (the entire financial spectrum as measured by the NYSE Fin. Index of over 200 financial issues). The Financial Index is one which I follow closely, and by the way, on December 7 Financials recorded a new high for the year at 56.80. Finally, the Standard & Poor's *Preferred Stock Index* has also been moving up steadily in RS, forming the third member of the "power-trio."

I think the fooler in the stock picture could be that (1) interest rates are going to come down considerably further than almost anyone realizes, (2) liquidity is going to continue to build among financial and non-financial corporations, (3) the rise in financially-oriented and money-oriented stocks is going to spearhead the entire second phase of the market. If so, the place to be is in money-financial types of stocks and stocks which offer high yields and rising dividends.

The Utilities have already experienced a big advance, but studying my long-term monthly charts, I note that the individual Utility shares have, for the most part, just moved out of their bases. I believe they have a long way to go on the upside. A few that I like are *Atlantic City Electric, Gulf States Utilities, Potomac Electric, Houston Lighting & Power.*

Among financials I like *CIT* and *US Life*. Both of these have shown gradual but steadily increasing earnings over the past year, and both have good chart patterns indicating accumulation. Two staid Dow stocks that I like for income are *American Can* and *American Brands*. And two companies which I feel have good futures and are worth holding (I have recommended them both many times) are *Addressograph-Multi.* (with Roy Ashe, its new president), and *SCM* (which is no longer a typewriter manufacturer but a true conglomerate). All the small weekly charts are courtesy of **Quote**, PO Box 213, Wichita, KA 67201.

LATE NOTES: A letter came in this morning asking me if I am "going to ignore the recent sell signal given by the 13 and 50 week moving averages?" I'm not ignoring it, but I am also not going to act on it at this time (the 13 week MA is now at 963, 8 points *below* the 50 week MA). There is no mechanical way of beating the market, and if there was, after thirty years of watching Wall Street I'll swear I would have found it. The current sell signal came against the prevailing primary trend. It is telling us that the Dow has indeed been weak, and it is telling us the moving averages are now in the same position that they have been at the onset of all major collapses. Nevertheless, I am taking the Dow Theory, the powerful Transport, Utility and Bond action and dozens of other factors into consideration, and I am saying, that I think the Dow will straighten itself out on the upside. If it doesn't, if instead of confirming the general market strength, the Dow brings down the market, then I hope to be one of the first to shout "Fire, it's all over." But so far I'm saying, "Sit tight. I think the action looks bullish, I think it looks good, I think all our patience is going to be rewarded. And I think (this being a primary bull market) that the Transports, the Utilities, the Bonds, and the breadth are telling us the story, and the Industrials are just being "reluctant worrywarts."

By the way, as late as December 7 the following indices recorded new bull market closing highs: The D-J Utilities, the NYSE Financial Index, the S&P Utilities, the cumulative most-active stock index (CMAS), my Primary Trend Index, the Advance-Decline Ratio for the NYSE, and the D-J 20-Bond Average. That may not be "total strength" across the board, but brother it's a lot of strength. The market appears short-term overbought here, but I'd be surprised if we get very much downside action with the kind of power listed above.

Potential bullish item: Bill Gordon writes that in November the short interest in the 30 Dow stocks jumped 32% to 2.7 million shares. That's an awful lot of speculators betting on a bull market collapse. I'm betting they're wrong.

EAST TO GOTHAM: I've been invited by *Barron's* to appear on their year-end panel along with a number of other gentlemen. The results of the panel discussions are fated to appear in a January issue of *Barron's*. So it's back to the city of my birth. We're leaving on December 9th, and if we can survive the cold, we'll stay about four or five days. Even though I'll have all my daily charts with me (if I miss a day on these, I'm lost!), we're going to try to make something resembling a minor vacation out of the trip. Therefore, I will be taking a few days extra off between this mailing and the next. Thus, ***the next mailing is scheduled for December 23.***

SURPRISE: Look at the A-D Ratio on the bottom of the page 3 chart. Not one in a thousand knows it, but the A-D Ratio has now risen almost 3 points from its October 25 low without so much as a 1 point correction. My definition of a "buying stampede" is a situation in which the A-D rises 5 points or more without an intervening correction of 1 point. If the Dow now gives the market any upside encouragement, the breadth (A-D Ratio) could turn into a powerhouse and a buying stampede would be underway. I think it could happen.